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# Proportionate liability – its impact on contractual risk allocation

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*This article considers the impact of proportionate liability legislation on contractual risk allocation, and why one might seek to contract out of the legislation. It was first published in this Journal in October 2006. Since that time, a number of issues have been clarified. Accordingly, an update is now timely.*

## INTRODUCTION

Proportionate liability legislation applies to situations where a person suffers economic loss or property damage as a result of the independent or joint acts or omissions of two or more people (concurrent wrongdoers). The legislation replaces the common law rule of “solidary” or joint and several liability – which allowed the injured party to recover 100% of its loss from any single concurrent wrongdoer – with a system which requires liability for the loss to be apportioned between the concurrent wrongdoers according to their respective responsibility for the loss. Each concurrent wrongdoer’s liability is limited to the amount of the loss apportioned to it.

The change, while significant, is not so drastic as it first sounds, since the former system did allow a person who was found by a court to be liable for 100% of another’s loss to seek contribution or indemnity from other concurrent wrongdoers according to their degree of fault. The most notable difference between the old and new systems is who bears the risk of insolvent or untraceable defendants. Under the old system, the plaintiff could recover the whole of its loss from a defendant with “deep pockets”, and any such defendant (or its insurer) would bear the risk of being unable to recover contribution from insolvent or untraceable concurrent wrongdoers. Under the new system, a plaintiff wishing to recover 100% of its loss must institute proceedings against all concurrent wrongdoers, and the risk of a concurrent wrongdoer being insolvent or untraceable is transferred to the plaintiff.<sup>1</sup>

Criticism of this transfer was the reason why proportionate liability proposals were rejected by the New South Wales Law Reform Commission in the early 1990s. However, the legislature has now drawn a distinction between the needs of those who suffer *personal injury* as a result of another’s lack of care, and those who suffer *purely financial loss or property damage*. Public policy now favours the former group being able to access damages as fully as possible, without shouldering the risk of insolvent or untraceable defendants. Public policy does not regard so highly the need to preserve a person’s financial security or property interests.<sup>2</sup>

Whether or not this is a justified distinction is not the concern of this article. Rather, the focus of this article is the impact of the new legislation on contractual risk allocation. This article does not consider the impact of proportionate liability legislation on litigation strategies.<sup>3</sup>

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<sup>1</sup> The extent to which this risk is transferred differs across the different jurisdictions, depending on whether the relevant legislation requires, allows or prohibits the court from having regard to the comparative responsibility of a concurrent wrongdoer who is not a party to the proceedings. See n 12. The transfer is not as great in Victoria, where the court is prohibited from having regard to the comparative responsibility of absent defendants (unless the person is not a party because the person is dead or, if a corporation, the corporation has been wound up).

<sup>2</sup> Except where that financial loss is the result of a defendant’s *intended* or *fraudulent* actions. These situations are excluded from the operation of the legislation.

<sup>3</sup> For a consideration of these aspects, see Uren AG and Aghion D, *Proportionate Liability: An Analysis of the Victorian and Commonwealth Legislative Schemes*, Commercial Bar Association Paper for CLE Seminar (18 August 2005). See also

## WHY WAS PROPORTIONATE LIABILITY LEGISLATION ENACTED?

In 1994, the Commonwealth and New South Wales Attorneys-General established an inquiry into the law of joint and several liability, as a result of growing concerns by professionals, particularly auditors, who had become targets of negligence actions not because of their culpability (which was often small) but because they were well insured and therefore able to pay large damages awards. The inquiry was conducted by Professor Davis, who recommended that joint and several liability for negligence which causes property damage or economic loss be replaced by liability which is proportionate to each defendant's degree of fault.<sup>4</sup>

However, it was not until after the insurance crisis which followed the collapse of the HIH Insurance Group in 2001<sup>5</sup> that legislation giving effect to Professor Davis' recommendation was enacted as part of a broader package of insurance-driven reforms to the law of negligence. Proportionate liability, coupled with the other reforms to negligence law, was intended to place downward pressure on the cost of liability insurance for professionals and local authorities – by preventing a court from sheeting home 100% of a plaintiff's loss to a well-insured wrongdoer when others were also partly responsible for the plaintiff's loss. This intention is clear in the report by Justice Ipp in 2002,<sup>6</sup> which prompted the legislation in New South Wales, and afterwards in other States and Territories.

## WHERE DOES PROPORTIONATE LIABILITY LEGISLATION APPLY?

All States and Territories have enacted proportionate liability legislation, in varying forms, in relation to claims for economic loss or property damage arising from a failure to take reasonable care, and for damages claims arising out of a contravention of the provisions in the Fair Trading Acts prohibiting misleading and deceptive conduct.<sup>7</sup> Proportionate liability legislation also exists at the federal level in the *Trade Practices Act 1974* (Cth), the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Act 2001* (Cth), in relation to remedies for misleading and deceptive conduct.<sup>8</sup>

The Victorian legislation was the first to commence on 1 January 2004 and applies to proceedings commenced on or after that date. The New South Wales legislation commenced on 1 December 2004 and applies to proceedings commenced on or after that date. The legislation in the other jurisdictions also generally commenced in 2004 or 2005.

The legislation does not apply to economic loss or property damage claims in situations of vicarious liability, partnership liability and statutorily-imposed several liability.<sup>9</sup> In some cases it also does not apply to liability of principals for their agents, and to the awarding of punitive or exemplary damages.<sup>10</sup>

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McDougall R, *Proportionate Liability in Construction Litigation* (2006), [http://www.lawlink.nsw.gov.au/lawlink/SupremeCourt/ll\\_sc.nsf/pages/SCO\\_mcdougall100706](http://www.lawlink.nsw.gov.au/lawlink/SupremeCourt/ll_sc.nsf/pages/SCO_mcdougall100706) viewed January 2010.

<sup>4</sup> Federal and State Attorney-General Departments (conducted by Prof Jim Davis), *Inquiry into the law of joint and several liability*, Report of Stage One (1994) and Report of Stage Two (1995) (Davis Inquiry).

<sup>5</sup> The collapse of the HIH Insurance Group, which held 35% of the professional indemnity insurance market, coupled with a general reduction in competition between insurers at about the same time, lead to significant increases in premiums for professional indemnity and public liability insurances and non-availability of insurance coverage above certain levels.

<sup>6</sup> Justice David Andrew Ipp, *Report of the Review into the Law of Negligence* (2 October 2002).

<sup>7</sup> *Civil Liability Act 2002* (NSW), Pt 4; *Wrongs Act 1958* (Vic), Pt IVAA; *Civil Liability Act 2002* (WA), Pt 1F; *Civil Liability Act 2003* (Qld), Pt 2; *Civil Law (Wrongs) Act 2002* (ACT), Ch 7A; *Proportionate Liability Act 2005* (NT); *Civil Liability Act 2002* (Tas), Pt 9A; *Law Reform (Contributory Negligence and Apportionment of Liability) Act 2001* (SA), Pt 3.

<sup>8</sup> It should be noted that whilst the proportionate liability scheme in the *Trade Practices Act 1974* (Cth) applies to misleading and deceptive conduct in breach of s 52, it does not apply to ss 53-59 of the *Trade Practices Act* which make misleading and deceptive conduct actionable in specific contexts.

<sup>9</sup> See, eg *Wrongs Act 1958* (Vic), s 24AP; *Civil Liability Act 2002* (NSW), s 39; *Trade Practices Act 1974* (Cth), s 87CI. This is in line with the Davis Inquiry Stage Two, n 4, p 6.

<sup>10</sup> See, eg *Wrongs Act 1958* (Vic), s 24AP(b) and (d).

A number of States and Territories had proportionate liability schemes in relation to claims for defective building work, in some cases for over 10 years.<sup>11</sup> In New South Wales, Victoria and the Northern Territory, the new general proportionate liability legislation has replaced the previous proportionate liability schemes for building claims. In South Australia, Tasmania and the Australian Capital Territory, the previous proportionate liability schemes for building claims co-exist with the new general proportionate liability schemes.

## HOW DOES THE LEGISLATION OPERATE?

While the proportionate liability legislation in each jurisdiction is similar, it is not uniform and there are some significant differences in the way in which proportionate liability now operates in each jurisdiction.<sup>12</sup> The purpose of this article is not to discuss the potential implications of the differences between the statutes, except insofar as it impacts on contractual risk allocation.

The legislation operates to restrict the courts, when ordering damages upon claims for pure economic loss or property damage arising from a failure to take reasonable care or from misleading and deceptive conduct, to such amounts as justly reflect each defendant's responsibility, and no more. Courts may (and in Western Australia, Tasmania and South Australia, must) look to the proportionate responsibility of absent defendants, except in Victoria where courts may look to the comparative responsibility of absent defendants only where they are not co-defendants because they are dead (real persons), or have been wound up (companies). Concurrent wrongdoers may be joined so that a court can assess the proportionate liability of all co-defendants in one action. A defendant against whom judgment is given as a concurrent wrongdoer cannot be required to contribute to any damages recovered from another concurrent wrongdoer, or be required to indemnify that person.

Plaintiffs may not recover more than their total loss by running separate actions and claiming inflated proportions of responsibility in each, since courts must look to previous damages awarded. However, plaintiffs risk recovering less than their total loss if separate actions are run, because courts are not bound to find the same proportionate responsibility for the later defendant as was attributed by the earlier court in which this party was not a defendant.

## POSSIBLE FUTURE CHANGES

Two reports commissioned by the National Justice CEOs Group make recommendations to clarify uncertainties in the application of proportionate liability legislations and to institute a uniform national model for the legislation:

- *Proportionate Liability: Towards National Consistency*, prepared by Mr Tony Horan and published in September 2007, provides a detailed analysis of the history, purpose and commentary on the legislation together with recommendations for its reform (the Horan Report);<sup>13</sup>

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<sup>11</sup> *Environmental Planning and Assessment Act 1979* (NSW), s 109ZJ (now repealed); *Building Act 1993* (Vic), ss 129-131 (now repealed); *Development Act 1993* (SA), s 72; *Building Act 1993* (NT), s 155 (now repealed); *Building Act 2004* (ACT), s 141; *Building Act 2000* (Tas), s 252.

<sup>12</sup> Perhaps the most significant difference between the schemes is the way they require courts to treat absent defendants. In some jurisdictions (Western Australia (s 5A), Tasmania (s 43B) and South Australia (s 8(2))), the legislation *requires* the court to have regard to the comparative responsibility of any concurrent wrongdoer who is not a party to the proceedings. In others (New South Wales (s 35), Queensland (s 31(3)), Commonwealth (*Trade Practices Act 1974* (Cth), s 87CD) and Northern Territory (s 13(2)(b))), the legislation gives the court a *discretion* to have regard to the comparative responsibility of absent defendants. Finally, in Victoria (s 24AI), the legislation *prohibits* a court from considering the comparative responsibility of a concurrent wrongdoer who is not a party to the proceeding *unless* the person is not a party because the person is dead or, if a corporation, the corporation has been wound up.

<sup>13</sup> Horan T, *Proportionate Liability: Towards National Consistency* (2007) (Horan Report), [http://www.justice.tas.gov.au/\\_data/assets/pdf\\_file/0017/113624/Horan\\_Report.pdf](http://www.justice.tas.gov.au/_data/assets/pdf_file/0017/113624/Horan_Report.pdf) viewed 18 January 2010.

- *Proportionate Liability: Proposals to Achieve National Uniformity*, prepared by Professor Jim Davis, puts forward more detailed drafting proposals to assist the Standing Committee of Attorneys-General (SCAG) to achieve national uniformity of the proportionate liability legislation (the Davis Report).<sup>14</sup>

The Horan Report makes 28 recommendations. The Davis Report makes 12 proposals, some of which support the Horan recommendations and some of which provide an alternative approach.

SCAG has released for consultation drafting instructions for model uniform legislation, taking into account the findings in the two reports.<sup>15</sup> The SCAG working group is refining the drafting instructions in light of the submissions received during the consultation process.

Where relevant, this article notes these recent developments and discusses their potential, if implemented, to impact upon the effect of proportionate liability legislation.

## HOW DOES THE LEGISLATION AFFECT CONTRACTUAL RISK ALLOCATION?

### Scenario 1: Co-contractors not solely responsible

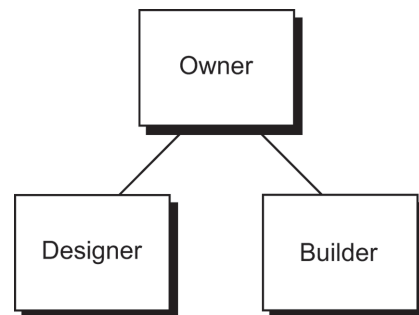
Suppose the following common factual scenario:

An owner contracts with a designer to design certain works, and then separately contracts with a builder to construct them.

Each of the designer and the builder owe duties to exercise reasonable care in carrying out their respective activities to the owner (both in contract and in tort).

The designer fails to exercise reasonable care and produces a defective design.

The builder also breaches its duty of care to the owner because it becomes aware of the design defects but fails to bring them to the attention of the owner and instead builds the works in accordance with the defective design, with the result that the works are defective and the owner suffers loss.



Prior to the introduction of the new general proportionate liability legislation, it was possible for the owner in this situation to recover 100% of its loss from either the designer or the builder (in which event the designer or the builder, as the case may be, would have a right to claim contribution from the other).<sup>16</sup>

Under the new regime (and assuming the owner is unable to, or does not, contract out of the regime), the owner will only be entitled to recover from each of the designer and the builder respectively that portion of its loss for which the relevant party is responsible. The owner will bear the risk of the designer or the builder being unable to satisfy its liability to the owner.

### Scenario 2: Head contractors not solely responsible

Now suppose another common factual scenario:

<sup>14</sup> Davis J, *Proportionate Liability: Proposals to Achieve National Uniformity* (2008) (Davis Report), [http://www.justice.tas.gov.au/\\_data/assets/pdf\\_file/0016/113623/Davis\\_Report.pdf](http://www.justice.tas.gov.au/_data/assets/pdf_file/0016/113623/Davis_Report.pdf) viewed 18 January 2010.

<sup>15</sup> Standing Committee of Attorneys-General 2008, *Drafting instructions for Uniform Proportionate Liability Provisions: Drafting instructions for Consultation* (2008), [http://www.justice.tas.gov.au/\\_data/assets/pdf\\_file/0020/113645/Drafting\\_Instructions\\_Prop\\_Liab\\_301008.pdf](http://www.justice.tas.gov.au/_data/assets/pdf_file/0020/113645/Drafting_Instructions_Prop_Liab_301008.pdf) viewed 18 January 2010.

<sup>16</sup> Although there was proportionate liability legislation in relation to building actions in some States and Territories prior to the introduction of the new general proportionate liability legislation, it was possible to draft around the previous building action legislation given the action had to be an action “for damages”. See Stephenson A, “Proportionate Liability in Australia – the Death of Certainty in Risk Allocation in Contract” [2005] *The International Construction Law Review* 64 at 66.

An owner contracts with a head contractor to construct certain works. The head contractor, in turn, subcontracts the construction of some of the works to a subcontractor.

The subcontractor fails to exercise reasonable care in carrying out its works and causes damage to other property owned by the owner.

The head contractor also fails to exercise reasonable care by not properly supervising the subcontractor – had it done so, it would have identified that the work was being constructed defectively.

Before the introduction of the new legislation, it was possible for the owner in this situation to recover 100% of its loss from the head contractor (in which event the head contractor would have had a right to claim contribution from the subcontractor). Accordingly, the owner could rely on the balance sheet of its head contractor to satisfy its losses, and did not need to concern itself with the financial capacity of subcontractors.

With the introduction of general proportionate liability legislation, it is no longer possible for the owner to rely solely upon the financial capacity of the head contractor to compensate the owner for any loss arising from a failure by the head contractor to exercise reasonable care.

In the above scenario, the head contractor will be entitled to have the owner's loss apportioned between it and the subcontractor according to their respective responsibility.<sup>17</sup>

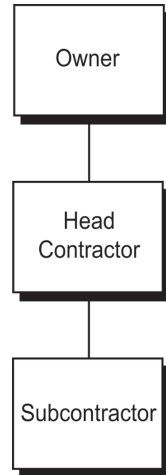
If the subcontractor carried out most of the relevant work and the head contractor's negligence is simply its failure to properly supervise the subcontractor then it is conceivable<sup>18</sup> that a significant portion of the owner's loss will be apportioned to the subcontractor, who may have little or no assets. Under the new proportionate liability legislation it is the owner, rather than the head contractor, who bears the risk of such a subcontractor being unable to pay its share of the owner's loss.

### MUST THE CONCURRENT WRONGDOER BE LEGALLY LIABLE TO THE PLAINTIFF?

The proportionate liability legislation in most jurisdictions generally defines a concurrent wrongdoer as one of two or more persons whose acts or omissions *caused* (either independently or jointly) the loss or damage that is the subject of the claim for damages. There is no express requirement that the person must also be *legally liable* to the plaintiff for that loss or damage it has caused in order to be a concurrent wrongdoer. Accordingly, when the legislation was first enacted, it was uncertain as to whether wrongdoers who caused a plaintiff's loss needed to be legally liable to the plaintiff for that loss to fall within the definition of concurrent wrongdoer. Was it enough, for example, if the act or omission gave rise to a legal liability to another concurrent wrongdoer, rather than the plaintiff?

This uncertainty seems to have been resolved by the Federal Court decision in *Shrimp v Landmark Operations Ltd* where Besanko J held that the word *caused* in the definition of concurrent wrongdoer "should be read as meaning such as to give rise to a liability in the concurrent wrongdoer to the plaintiff".<sup>19</sup>

Any remaining uncertainty will be removed if the SCAG instructions for harmonising the legislation are implemented. The SCAG's drafting instructions adopt recommendations made by Horan and Davis on this issue,<sup>20</sup> and direct that the definition of "concurrent wrongdoer" be amended to mean one of two or more persons who:



<sup>17</sup> See, eg *Yates v Mobile Marine Repairs Pty Ltd* [2007] NSWSC 1463, where a head contractor who breached its contractual obligations to its client by failing to take reasonable care to ensure that repair work performed by its subcontractor was performed properly, was found to be liable for only 50% of the client's loss, with the subcontractor being held liable for the other 50%.

<sup>18</sup> Particularly if the subcontractor is performing work in an area in which the head contractor has limited knowledge or expertise and is relying on the skill of the subcontractor.

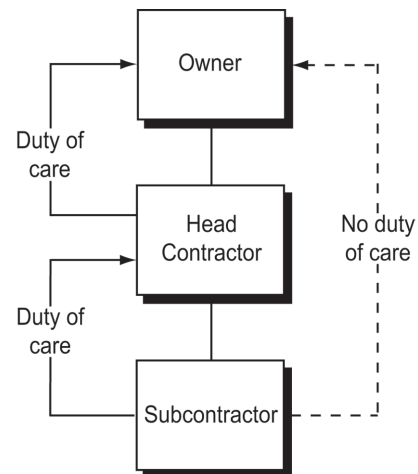
<sup>19</sup> *Shrimp v Landmark Operations Ltd* (2007) 163 FCR 510 at [62]; [2007] FCA 1468.

<sup>20</sup> See Horan Report, n 13, Recommendation 9; Davis Report, n 14, Proposal 3.



- not only caused, but is also legally liable for, the loss or damage which is the subject of the apportionable claim, even if an act or omission of the plaintiff has extinguished that liability; and
- caused that loss independently of each other or jointly.<sup>21</sup>

Accordingly, the outcome in Scenario 2 discussed above will be different if the negligence of the head contractor and the subcontractor results in defective building work which causes the owner to incur pure economic loss in the form of defect rectification costs, additional maintenance costs or diminution in value of the works (as opposed to damage to other property of the owner). This is because a subcontractor will not ordinarily owe a duty of care to an owner to avoid pure economic loss, and will therefore not be legally liable to the owner for that loss.<sup>22</sup> Accordingly, in such a scenario, the owner would be entitled to recover 100% of its loss from the head contractor (assuming there are no other concurrent wrongdoers). The head contractor would be entitled to recover damages from the subcontractor, subject to reduction on account of the head contractor's contributory negligence.



### Collateral warranties

It is not unusual for owners to require head contractors to procure collateral warranties from subcontractors directly in favour of the owner. These collateral warranties may incorporate an express or implied contractual duty of care from the subcontractor to the owner. Accordingly, such collateral warranties can now be a two-edged sword. While they provide the owner with direct contractual rights against the subcontractor, by establishing a duty of care from the subcontractor to the owner which might not otherwise have existed, they can also provide the head contractor with a basis on which to assert that liability for any loss caused by both the head contractor and the subcontractor should be apportioned between them in accordance with the legislation. Accordingly, owners must now think carefully about the possible downsides of direct contractual warranties, particularly in those jurisdictions where it is not possible to contract out of the new proportionate liability legislation.

### Strict contractual obligations

Most contracts include strict contractual obligations in the sense that if the contractor fails to comply with the obligation it will be liable for breach of contract, whether or not the breach was due to any want of reasonable care on the part of the contractor. For example, if a contractor warrants that the works will be fit for their intended purpose, and the completed works are not fit for their intended purpose, the contractor will be liable for breach of the warranty whether or not the contractor has failed to take reasonable care.

A question arises as to whether a claim for breach of a strict contractual obligation can fall within the purview of the proportionate liability legislation. To answer this question one must consider the definition of “apportionable claim”.

Section 34(1) of the *Civil Liability Act 2002* (NSW) defines an apportionable claim to include:

<sup>21</sup> See Standing Committee of Attorneys-General, n 15, pp 5-6 (emphasis added).

<sup>22</sup> In Australia, the loss suffered by an owner as a result of defective building work, being the diminution in value of the building or the cost of rectifying the defects, is categorised as pure economic loss: see *Bryan v Maloney* (1995) 182 CLR 609 at 617 (Mason CJ, Deane and Gaudron JJ), 657 (Toohey J); cf at 643 (Brennan J). For a duty of care to avoid pure economic loss to arise, something more than mere foreseeability of loss is required. Other factors must also be considered in determining whether a duty exists, such as the vulnerability of the plaintiff, indeterminacy of liability, autonomy of the individual and the defendant's knowledge of the risk and its magnitude: see *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515. An owner is unlikely to be sufficiently vulnerable (ie unable to protect itself from the risk of defective work by a subcontractor) for a duty of care to exist.

a claim for economic loss or damage to property in an action for damages (whether in contract, tort or otherwise) arising from a *failure to take reasonable care*.<sup>23</sup>

However, the Queensland definition is in slightly different terms. It defines an apportionable claim to include:

a claim for economic loss or damage to property in an action for damages arising from a *breach of a duty of care*.<sup>24</sup>

The South Australian legislation takes a different approach again, as it does not have a concept of “apportionable claims”. However, in relation to claims for breach of contract, s 4(1) of the *Law Reform (Contributory Negligence and Apportionment of Liability) Act 2001* (SA) makes it clear that it only applies to “a liability in damages for a breach of a *contractual duty of care*” (emphasis added). In New South Wales (and the other jurisdictions which define an apportionable claim in similar terms), it would seem that there are at least three possible views on how the legislation applies to a claim for breach of a contractual obligation:

***First possible interpretation – contractual claims for breach of a contractual duty of care only***

The first view is that the legislation only applies to contractual claims where the breach is breach of an express or implied contractual promise to exercise reasonable care. On this interpretation, contractual claims for breach of contractual obligations other than a contractual duty of care would be excluded from proportionate liability legislation.

This seems to be the view preferred by Justice Byrne in a paper which he delivered in May 2006.<sup>25</sup> It is also the approach preferred by Professor Davis,<sup>26</sup> who recommends that an “apportionable claim” should only arise only from:

- a breach of a tortious duty of care, or from a breach of a contractual obligation which is concurrent and co-extensive with such a tortious duty; or
- a breach of the statutory prohibition on misleading [or deceptive] conduct.

Davis’ recommendation has been adopted by SCAG in their drafting instructions.<sup>27</sup> The words “or deceptive” have been added to Davis’ recommendation by SCAG. The proposed amendment would mean that the only contractual claims to which the legislation would apply would be claims for breach of a contractual obligation to exercise “due care and skill”, or other contractual obligations which mirror tortious duties (such as a contractual obligation not to cause nuisance). The decision in *Yates v Mobile Marine Repairs Pty Ltd*<sup>28</sup> concerned a contractual obligation of this kind.

However, the current drafting of the legislation does not support such a narrow view, nor does it fit well with the purpose of the legislation. It is also inconsistent with the interpretation preferred in a number of recent decisions which are discussed in relation to the second possible interpretation below, particularly *Reinhold v New South Wales Lotteries Corp (No 2)*.<sup>29</sup>

The arguments against this interpretation include the following:

1. The purpose of the legislation, as evident from the Second Reading Speeches,<sup>30</sup> is to protect liability insurers. The majority of liability insurance is professional liability insurance. These policies

<sup>23</sup> (emphasis added). The definitions in Victoria (s 24AF), Western Australia (s 5AI), Tasmania (s 43A), the Northern Territory (s 4) and the Australian Capital Territory (s 107B) are in similar terms.

<sup>24</sup> *Civil Liability Act 2003* (Qld), s 28(1)(a) (emphasis added).

<sup>25</sup> Byrne D, *Proportionate Liability: Some Creaking in the Superstructure*, Presented to the Judicial College of Victoria (19 May 2006) at [20(4)].

<sup>26</sup> See Davis Report, n 14.

<sup>27</sup> See Standing Committee of Attorneys-General, n 15, pp 5-6.

<sup>28</sup> *Yates v Mobile Marine Repairs Pty Ltd* [2007] NSWSC 1463.

<sup>29</sup> *Reinhold v New South Wales Lotteries Corp (No 2)* [2008] NSWSC 187.

<sup>30</sup> See, eg Legislative Assembly, “Civil Liability Amendment (Personal Responsibility) Bill”, *Hansard*, Second Reading Speech, Hon Robert Carr (23 October 2002) p 5764; see also Legislative Assembly, “Wrongs and Limitation of Actions Act (Insurance Reform) Bill”, *Hansard*, Hon Stephen Bracks (21 May 2003) p 73.

will usually respond to any liability assumed by the insured under the terms of any guarantee, indemnity, warranty of performance or suitability for purpose, provided that such liability would nevertheless have attached to the insured in the absence of such guarantee, indemnity or warranty. The insurance will therefore cover a liability, irrespective of the way in which the cause of action from which the liability derives is pleaded.

Take for example, a builder who was negligent in the execution of its duties, but is sued for breach of a contractual warranty for fitness of purpose. Under this interpretation, the cause of action would not be governed by proportionate liability legislation and the builder may be held liable for 100% of the loss, despite the fact that it may have contributed to the loss in conjunction with other concurrent wrongdoers. If the cause of action had been pleaded differently, ie as a breach of a duty of care, then the proportionate liability legislation would have been activated and the both the builder and its professional indemnity insurer protected from responsibility for the whole of the loss.

Therefore, given the nature of these policies and the purpose of the proportionate liability legislation, it is strongly arguable that the words “arising from failure to exercise reasonable care” should not be interpreted to catch only contractual claims pleaded as claims “for a breach of a contractual duty of care”. To do otherwise would deprive liability insurers from the benefit of the legislation (and, therefore, not achieve the purpose of the legislation) where the action is based on breach of a strict contractual obligation rather than a breach of a duty of care, even though the liability arises as a consequence of a failure to exercise reasonable care.

2. The legislation in New South Wales, Victoria, Western Australia, Tasmania, the Northern Territory and the Australian Capital Territory states that apportionable claims are claims “arising from a *failure to take reasonable care*”. They do not limit apportionable claims to claims “arising from a *breach of a duty of care*”. For the reasons mentioned at (1) above, this choice of language appears to be deliberate and consistent with the policy of the legislation as outlined in the relevant Second Reading Speeches. The natural meaning of the words “arising from a failure to take reasonable care” does not support the view that “claims” should be limited to claims pleaded as claims for breach of a duty of care.

3. This interpretation would also mean that the new proportionate liability legislation will have narrower application than the former proportionate liability schemes for building claims which the new, broader legislation has replaced in some States and Territories. In particular, the new legislation, unlike the previous legislation, would not apply to building cases where the claim is a failure to comply with a strict contractual obligation.

***Second possible interpretation – contractual claims which factually arise from a failure to exercise reasonable care***

A second possible interpretation which has gained some support in the cases is that the legislation applies to claims for breach of a strict contractual obligation provided the act or omission which gives rise to the breach of contract *factually arises from a failure to exercise reasonable care*.

This view seems to be the most plausible interpretation of the legislation as it currently stands since:

- (a) it gives the words “arising from a failure to take reasonable care” their plain and ordinary meaning; and
- (b) it gives effect to the policy of the legislation by assisting those professional indemnity insurers who write their policies in terms which cover contractual liability provided it “arises from a failure to take reasonable care”.

One consequence of this interpretation is that a concurrent wrongdoer who happens to breach a strict contractual obligation as a result of his or her own negligence is able to avoid joint and several liability whereas a concurrent wrongdoer who breaches the same obligation without being negligent is not. At first blush, this result seems to be an odd one, as it renders the negligent better off than the non-negligent. However, it is not so odd once one remembers that the purpose of the legislation, as evident from the Second Reading Speeches, is to protect liability insurers (who, as noted above, will ordinarily be liable to indemnify an insured for damages arising from a breach by the insured of a



strict contractual obligation provided that such liability would nevertheless have attached to the insured in the absence of the strict contractual obligation).

This interpretation creates a tactical change for a plaintiff, who may now wish to prove that the defendant did not fail to take reasonable care, in order to enforce the strict liability and to recover 100% of its loss rather than recovering an apportioned claim under the new regime. On the flip side, defendants may wish to prove they *did* fail to take reasonable care, but in some minor way, so as to bring their liability under the limits created by proportionate liability.

Recent case law supports this interpretation. The strongest support comes from the New South Wales Supreme Court decision of *Reinhold v New South Wales Lotteries Corp (No 2)*.<sup>31</sup> That case concerned the wrongful cancellation of a winning lottery ticket. The court found that both the newsagents and the New South Wales Lotteries Corp were guilty of a breach of contract by cancelling the ticket other than in accordance with the Oz Lotto Rules. The court also found that each of the newsagents and New South Wales Lotteries Corp had breached a duty of care in negligence owed by them to the plaintiff ticket holder.

The plaintiff argued that the New South Wales proportionate liability scheme did not apply to the claims for breach of contract because the relevant contractual term was concerned with whether the ticket had been cancelled in accordance with the rules. The plaintiff submitted that a claim for breach of contract within s 34(1)(a) of the *Civil Liability Act 2002* (NSW) only where the breach is a breach of an express or implied term requiring that reasonable care be taken. Barrett J rejected this submission and held that the claims for breach of contract were apportionable on the basis of the factual finding that they arose from a failure to take reasonable care.

Barrett J drew support for this conclusion from the fact that the words in s 34(1)(a) do not follow the pattern found in the modified Pt 3 of the *Law Reform (Miscellaneous Provisions) Act 1965* (NSW) which make a plaintiff's contributory negligence relevant to the assessment of damages for "a breach of a contractual duty of care that is concurrent or co-extensive with a duty of care in tort"<sup>32</sup> – the formulation which Davis has recommended now be adopted in the proportionate liability legislation throughout Australia.

Barrett J also drew support for his conclusion from the observations of Middleton J in the Federal Court decision of *Dartberg Pty Ltd v Wealthcare Financial Planning Pty Ltd*, where his Honour stated:

Where a claim brought by an applicant does not have as one of its necessary elements any allegation of failing to take reasonable care, an additional enquiry into the failure to take reasonable care may become relevant in the course of a trial to determine the application of Pt IVAA. Even though the claims in this proceeding themselves do not rely upon any plea of negligence or a "failure to take reasonable care" in a strict sense, a failure to take reasonable care may form part of the allegations or the evidence that is tendered in the proceedings. At the end of the trial, after hearing all the evidence, it may be found that Pt IVAA applies.<sup>33</sup>

Further support for this position can be drawn from the Victorian Supreme Court decision in *Woods v De Gabriele*, where Hollingworth J considered the issue in the context of Pt IVAA of the *Wrongs Act 1958* (Vic) and stated that:

it is at least arguable that a claim should be regarded as apportionable under s 24AF(1)(a) of the *Wrongs Act*, if the facts on which the claim is based include allegations of a failure to take reasonable care, whether or not the plaintiff chooses to give it that name. In other words, it is arguable that an apportionable claim is a claim for economic loss or damage to property that arises, on the facts, from a failure to take reasonable care.<sup>34</sup>

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<sup>31</sup> *Reinhold v New South Wales Lotteries Corp (No 2)* [2008] NSWSC 187.

<sup>32</sup> *Reinhold v New South Wales Lotteries Corp (No 2)* [2008] NSWSC 187 at [28].

<sup>33</sup> *Dartberg Pty Ltd v Wealthcare Financial Planning Pty Ltd* (2007) 164 FCR 450 at [30]; [2007] FCA 1216.

<sup>34</sup> *Woods v De Gabriele* [2007] VSC 177 at [58].

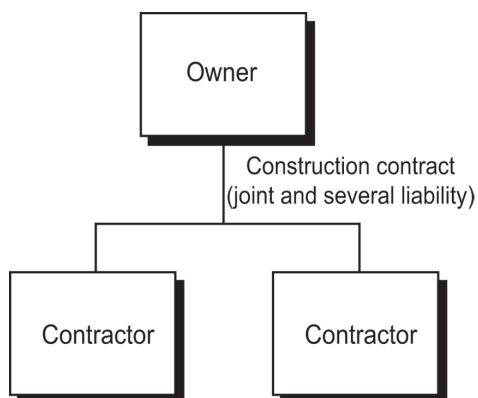
### **Third possible interpretation – no contractual claims**

In the Victorian Civil and Administrative Tribunal decision in *Lawley v Terrace Designs Pty Ltd*, Senior Member Young expressed a third view, holding that “purely contractual claims are not apportionable”.<sup>35</sup> Senior Member Young held that an owner’s claim for breach of the statutory warranties implied in the building contract, including breach of the warranty that the builder would carry out the work with reasonable care and skill, were not apportionable claims. “The owner’[r]s claims against the builder [is] contractual, the gist of the action is a breach of contract not a failure to take reasonable care”.<sup>36</sup>

With respect, it is suggested that Senior Member Young erred in reaching his conclusion. While Senior Member Young purported to rely on the view expressed by Byrne J, his findings are in fact inconsistent with those expressed by Byrne J who, as noted above, prefers the first view that a claim for breach of contract will not be an apportionable claim “unless the term breached is one to take reasonable care”.<sup>37</sup> Further, given the express reference to “contractual” claims in the definition of apportionable claim, it surely must, as a minimum, apply to claims for breach of a contractual obligation to take reasonable care.

### **Scenario 3: Joint venture contractors not jointly and severally liable**

It is not uncommon on major projects for an owner to contract with a joint venture comprising two or more contractors, on the basis that each is jointly and severally liable for all obligations of the joint venture under the contract.



Such an arrangement allows the owner, and its equity and debt providers (in the case of privately financed projects), to rely on all entities comprising the joint venture (and their collective balance sheets) to deliver on the promises made, or to pay damages in the event they fail to do so. The owner can sue any, or all, of them for 100% of its loss. Accordingly, even if one of the joint venturers was to become insolvent (perhaps due to losses on other projects), the owner will still be entitled to fully enforce the contract against the others.

However, it would appear that under those proportionate liability schemes which do not allow contracting out (see below), where all joint venture contractors are actively involved in construction activities and all fail to exercise reasonable care, the maximum liability of each will be that proportion of the total loss which the court considers fair having regard to the extent of each contractor’s responsibility.<sup>38</sup>

There is also the possibility that the joint venturers agree between themselves how the risks should lie, for example, in a 40%/60% split. A court may apportion liability between them in different proportions, thereby undermining the contractually agreed risk-sharing position. Whether or not the agreement will supersede the court order, or be considered by the court when making its determination, depends on the provisions barring a wrongdoer from claiming, after the judgment, contributions and indemnities. The possible interpretations of such provisions are discussed below. If

<sup>35</sup> *Lawley v Terrace Designs Pty Ltd* [2006] VCAT 1363 at [317].

<sup>36</sup> *Lawley v Terrace Designs Pty Ltd* [2006] VCAT 1363 at [318].

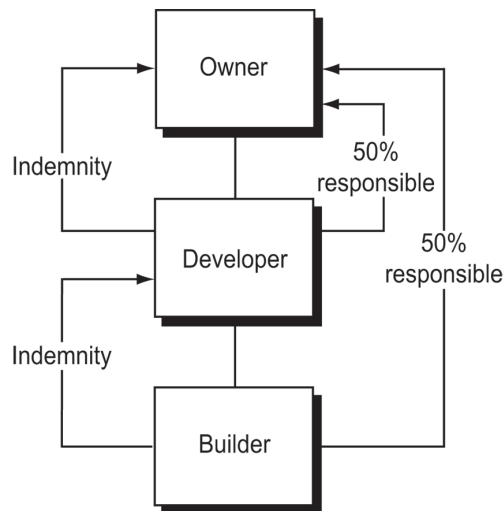
<sup>37</sup> Byrne, n 25 at [20(4)].

<sup>38</sup> The situation will be different if one of the joint venturers is not actively involved in the construction activities, but merely provides the necessary balance sheet support, and the other is solely responsible for the construction. In this case, the contractor that is not involved in the construction activities will not be a concurrent wrongdoer, and the proportionate liability legislation will not apply.

liability depends only on the facts, not on risk-sharing agreements, principals, debt and equity providers and joint venture parties face uncertainty when entering into their transactions.<sup>39</sup>

## Indemnities

Let us consider now another scenario:



An owner contracts with a developer for the construction of a new building. The contract between the owner and the developer states that the developer will indemnify the owner for all losses incurred by the owner as a result of the developer's activities.

The developer, in turn, engages a builder to construct the building. The contract between the developer and the builder contains a similar indemnity clause under which the builder agrees to indemnify the developer for all losses incurred by the developer as a result of the builder's activities.

Let us also assume for this example that:

- both the developer and the builder breach direct contractual obligations to the owner to exercise reasonable care in the performance of their activities, such that the owner has a cause of action for breach of this contractual duty against each of them to recover its loss;<sup>40</sup> and
- on a factual inquiry, the court finds that the developer and the builder are each 50% responsible for the owner's loss.

If the contractual indemnities are given their full force and are not affected by the proportionate liability legislation, the owner will be entitled to recover 100% of its loss from the developer. The developer, in turn, will be entitled to recover 100% of its loss from the builder.

There is a concern, however, that indemnities of this nature may now be ineffective as a consequence of the provisions in the new proportionate liability legislation in some jurisdictions which seek to protect concurrent wrongdoers from paying more than their apportioned liability.

The relevant provision in the *Civil Liability Act 2002* (NSW) is s 36, which states (emphasis added):

A defendant against whom judgement is given under this Part as a concurrent wrongdoer in relation to an apportionable claim:

- cannot be required to contribute to any damages or contribution recovered from another concurrent wrongdoer in respect of the apportionable claim (whether or not the damages or contribution are recovered in the same proceedings in which judgment is given against the defendant), and
- cannot be required to *indemnify* any such wrongdoer.

The legislation in most of the other jurisdictions uses substantially similar terms.<sup>41</sup>

A plain reading of para (b) of s 36 suggests that contractual indemnities between concurrent wrongdoers are no longer effective to the extent that they require a concurrent wrongdoer to bear more than the liability apportioned to it by the court. Such a reading of para (b) would not affect the indemnity from the developer to the owner, as the owner is not a concurrent wrongdoer. However, it would affect the indemnity from the builder to the developer, such that the developer would not be

<sup>39</sup> For further discussion, see Stephenson, n 16 at 77.

<sup>40</sup> While it would be unusual for the builder to owe a direct contractual duty of care to the owner, this assumption conveniently makes it clear that the owner will have an independent cause of action against the builder.

<sup>41</sup> *Wrongs Act 1958* (Vic), s 24AJ; *Civil Liability Act 2003* (Qld), s 32A; *Civil Liability Act 2002* (WA), s 5AL; *Proportionate Liability Act 2005* (NT), s 15; *Civil Liability Act 2002* (Tas), s 43C.

able to require the builder to indemnify the developer for its 50% liability to the owner. In other words, the developer would remain liable for 50% of the owner's loss, despite it having entered into the transaction on the basis of a full indemnity from the builder.

If such an interpretation is correct, the builder, who has contractually agreed to bear 100% of the developer's liability, has an incentive to become a defendant and to adduce evidence to prove its own negligence (but only a little), in order to receive a judgement *against it* which will preclude the developer from being able to claim under the indemnity from the builder. The builder succeeds in escaping its indemnity obligations.<sup>42</sup>

As noted by Uren and Aghion:

it seems unlikely that Parliament would have intended to so drastically affect a party's commercial bargain. It also seems to be counter to the policy behind the legislation of responding to the perceived "insurance crisis". One of the ways in which commercial parties arrange their affairs is to require parties contracting with them to provide a full indemnity and to carry insurance for any loss. Why would the legislation cut across that arrangement, thereby increasing the risk of creating an uninsured defendant?<sup>43</sup>

There are, however, it seems at least two alternative interpretations of s 36 and the equivalent provisions in other jurisdictions.

The first alternative interpretation is that para (b) is only directed at *common law* rights of indemnity, as opposed to *contractual* rights of indemnity. In this regard, a tortfeasor has a common law right to complete indemnity from another tortfeasor if he or she can demonstrate that the tort is at base the wrong doing of the other.<sup>44</sup> Slightly differently, McDonald has suggested that the legislation allows a defendant to enforce a contractual indemnity against a co-defendant, although the court cannot require one defendant to indemnify another (under s 36 in New South Wales):

It seems unlikely that the legislation would be interpreted as manifesting an intention to interfere and cut down pre-existing contractual indemnities, or as impliedly doing so. It would appear that the better view is that, where the wrongdoer has the benefit of a pre-existing contractual indemnity for its share of the responsibility, the section above only prevents a *court* requiring a person to indemnify another while it is the *contract* which "requires" the indemnity and that this contract can be enforced separately.<sup>45</sup>

A second possible interpretation is suggested by Watson.<sup>46</sup> His suggestion is a literal reading, in which the section only prohibits indemnification *after* judgment. A claim on indemnity will usually be made during the proceedings and the court is to apportion liability as would be "just having regard to the extent of the person's responsibility for the damage or loss".<sup>47</sup> The indemnity agreement could be considered by the court (*before* handing down its judgment) as a factor informing the extent of a party's responsibility. This means responsibility would not be simply factual/causal responsibility, but also contractually assumed responsibility.<sup>48</sup> Alternatively, or in addition, an indemnity agreement could be considered as a factor in what is "just" between the parties. It is important to note, though,

<sup>42</sup> As noted above, a plain reading of s 36 would not prohibit the owner from enforcing its indemnity from the developer. Nor would it prevent the developer or the builder from enforcing an indemnity agreement against parties who are not wrongdoers, such as their insurers or a guarantor of the builder.

<sup>43</sup> Uren and Algion, n 3, p 20.

<sup>44</sup> For example, a principal or employer is liable to indemnify his agent or servant for any tortious liability arising out of an act requested by the former except where the act is manifestly illegal in itself (*Adamson v Jarvis* (1827) 4 Bing 66). This right to indemnification was developed by the courts to ameliorate the decision in *Merryweather v Nixan* (1799) 8 Term Rep 186, which was generally taken as establishing the rule that there was no common law right to contribution or indemnification between joint tortfeasors. See Atiyah PS, *The Law of Vicarious Liability in Torts* (Butterworths, London, 1967) pp 421-422.

<sup>45</sup> McDonald B, "Proportionate Liability in Australia: The Devil in the Detail" (2005) 26 *Australian Bar Review* 29 at 44.

<sup>46</sup> Watson J, "From Contribution to Apportioned Contribution to Proportionate Liability" (2004) 78 ALJ 126 at 144.

<sup>47</sup> For example, *Civil Liability Act* (NSW), s 35; *ASIC Act* (Cth), s 12GR; *Corporations Act 2001* (Cth), s 1041N(1)(a); *Trade Practices Act 1974* (Cth), s 87CD(1)(a).

<sup>48</sup> Uren and Aghion also consider this interpretation, see n 3, p 21.

that even on this literal interpretation, the court will not *necessarily* enforce the indemnity agreement, nor will it necessarily stick to the amounts provided for within that agreement. Contractual certainty is still not guaranteed.

The Victorian Department of Justice contemplates this interpretation in paras [45]-[53] of its Discussion Paper on Pt IVAA of the *Wrongs Act 1958* (Vic).<sup>49</sup> However, it is less critical than Watson, instead stating that:

The advantage of this option is that it is conceivable that in some cases a concurrent wrongdoer *should* be found liable to a greater or lesser extent than precisely what their contract stipulates. Arguably, the court should have a discretion to override contractual liability (to some extent) or at least apply a flexible approach to cases where there is a manifest discord between contractual allocation of risk and a defendant's "moral responsibility" for causing a loss.<sup>50</sup>

However, it also notes that the court's discretion under this approach may encourage parties to litigate rather than settle in the hope of reducing their contractual liabilities.<sup>51</sup>

On balance, the writer prefers the first possible interpretation, i.e. that the provision only applies to common law indemnities, and not contractual indemnities. However, it is noted that if this was indeed the intention of the legislatures in New South Wales, Victoria and Queensland, they could have expressly excluded contractual indemnities from the operation of the provision. Indeed, the legislatures in Western Australia, the Northern Territory and Tasmania have done just that by including the following subsection in their legislation:

Subsection (1) does not affect an agreement by a defendant to contribute to the damages recoverable from, or to indemnify, another concurrent wrongdoer in relation to an apportionable claim.<sup>52</sup>

Unfortunately, in New South Wales, Victoria and Queensland the position will remain uncertain until such time as the courts resolve this issue, or the legislatures pass appropriate amendments clarifying the position – clearly a less than satisfactory situation.

Such clarification may be forthcoming, as Horan and Davis both recommend that the provisions in the legislation which state that a defendant cannot be required to contribute to any damages or contribution recovered from another concurrent wrongdoer and cannot be required to indemnify any such wrongdoer be followed by a subsection stating:

Subsection (1) does not affect an agreement by a defendant to contribute to the damages recoverable from or to indemnify another concurrent wrongdoer in relation to an apportionable claim.<sup>53</sup>

This recommendation is in line with the first alternative discussed above, is adopted by SCAG in its drafting instructions,<sup>54</sup> and comes as welcome news to those who require the certainty of the established risk allocation in their contractual arrangements, both for their own peace of mind and for that of their insurers, financiers and guarantors.

### **Where joint and several liability continues unaffected**

It should also be noted that there is (very limited) judicial authority for an interpretation that allows joint and severable liability to continue *despite* the seeming applicability of proportionate liability legislation.

In *Labour v Pehlivan*<sup>55</sup> Senior Member Vassie was faced with an action under the *Consumer Credit (Victoria) Act 1995* (Vic) and the *Fair Trading Act 1999* (Vic), in which some claims were

<sup>49</sup> Victorian Department of Justice, *Review of Contractual Allocation of Risk and Part IVAA of the Wrongs Act 1958*, Discussion Paper (2005).

<sup>50</sup> Victorian Department of Justice Discussion Paper, n 49 at [47].

<sup>51</sup> Victorian Department of Justice Discussion Paper, n 49 at [49].

<sup>52</sup> *Civil Liability Act 2002* (WA), s 5AL(2); *Proportionate Liability Act 2005* (NT), s 15(2); *Civil Liability Act 2002* (Tas), s 43C(2).

<sup>53</sup> See Horan Report, n 13, Recommendation 25; Davis Report, n 14, Proposal 7.

<sup>54</sup> See Standing Committee of Attorneys-General, n 15, pp 16-20.

<sup>55</sup> *Labour v Pehlivan* [2006] ASC 155-079; [2005] VCAT 1900.



apportionable and some were not. That in itself did not cause difficulty. However, trouble arose when it came to apportioning the liability between two defendants who were jointly and severally liable for a misleading statement. The judge was unable, on the evidence, to “gauge the comparative responsibility”.<sup>56</sup> Instead of then dividing the sum into two apportioned lots (perhaps equally as a default position), he declared that “[i]n these circumstances, in my opinion, the provisions of the *Wrongs Act* that I have mentioned do not operate”.<sup>57</sup>

This is indeed a startling proposition. It leaves defendants vulnerable to wearing 100% of the burden *even when* they are only partially at fault, in situations where it is accepted that other defendants were at fault but the comparative portions cannot be calculated on the evidence. The risk of a co-defendant’s insolvency is put back on the other defendants. This reverses the intended result of the proportionate liability provisions; it does nothing to reduce the insurance problems that first sparked the legislative reform.

It is possible to question any decision that seeks to oust the application of legislation on the grounds that the evidence available made it too difficult to make a determination under that legislation.

### **Liability of guarantors**

It is common for principals to construction contracts to require the parent company of the contractor to provide a guarantee in respect of the obligations of the contractor under the construction contract. Often, the guarantee document will also contain an indemnity from the guarantor in respect of any loss suffered by the principal as a result of any failure by the contractor to perform the guaranteed obligations.

*Commonwealth Bank of Australia v Witherow*,<sup>58</sup> provides some guidance in relation to the effect of the legislation on the liability of guarantors. In this case, the court had to consider the application of Pt IVAA of the *Wrongs Act 1958* (Vic) to a claim by a bank for enforcement of a guarantee in circumstances where the guarantor was alleging that the guarantor had suffered loss because of his accountant’s failure to take reasonable care in advising him on the financial position of the borrower. The court held that the legislation did not apply to the bank’s claim against the guarantor under a guarantee, because such a claim is not a claim “in an action for damages ... arising from a failure to take reasonable care”. Rather, it was, in effect, a claim for specific performance of a contract of guarantee. The same reasoning would seem to apply to a claim under the above-mentioned indemnity contained in many guarantee documents.

The liability of a guarantor to a principal under a guarantee will usually be limited to the liability of the contractor to the principal under the contract. Accordingly, if a court determines that the contractor is only liable for a portion of the principal’s loss, the guarantor will only be liable under the guarantee for that determined portion.

However, if the guarantee document also contains an indemnity on the terms mentioned above and does not contain any other provision which limits the guarantor’s liability under the indemnity by reference to the amount for which the contractor is liable, the guarantor may be liable under the indemnity for 100% of the principal’s loss, rather than the portion for which the contractor is found liable. Accordingly, guarantors will wish to carefully consider the terms of any indemnity contained in a guarantee document where the parties are contracting on the basis that proportionate liability legislation should apply in respect of parties’ rights and obligations under the construction contract.

## **IS IT POSSIBLE TO CONTRACT OUT OF PROPORTIONATE LIABILITY LEGISLATION?**

### **Introductory remarks**

The proportionate liability provisions benefit defendants rather than plaintiffs. A principal to a construction or service contract is more likely to be the plaintiff than the defendant in any claim

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<sup>56</sup> *Labour v Pehlivan* [2006] ASC 155-079 at [93]; [2005] VCAT 1900.

<sup>57</sup> *Labour v Pehlivan* [2006] ASC 155-079 at [94]; [2005] VCAT 1900.

<sup>58</sup> *Commonwealth Bank of Australia v Witherow* [2006] VSCA 45.

between the principal and the contractor arising out of a failure by a party to take reasonable care. Accordingly, it is therefore likely to be advantageous to principals to avoid the application of proportionate liability regimes and, similarly, for head contractors in their contacts with subcontractors.

There are a number of potential ways in which parties may contract out of the schemes. Whether they are all permissible in all jurisdictions is debatable. Some potential solutions in those jurisdictions that allow contracting out are:

- (a) to include a clause in the contract which expressly states that the relevant proportionate liability legislation does not apply to any claim between the parties; and/or
- (b) to include provisions in the contract which provide that in the event that either or both of the parties are subject to an apportionable claim, liability is to be apportioned between them in a particular way. For example:
  - (i) including indemnities from one party to another; or
  - (ii) where the owner is contracting with a joint venture and wants each joint venture contractor to be jointly and severally liable, including a provision in the contract stating that each joint venturer is jointly and severally liable.

A separate escape route which does not depend on the relevant Act expressly allowing the parties to contract out of the legislation may be to refer all disputes which arise under the contract to arbitration (or some other form of consensual alternative dispute resolution). However, this last option may not be possible in all jurisdictions.

The ability of parties to contract out of the legislation in some jurisdictions but not others may also impact on the law chosen by the parties to govern their contract.

When considering whether a party can or should agree to contract out of the relevant proportionate liability scheme, one should consider the effect that any such attempt may have on any professional indemnity insurance that that party has undertaken. This is discussed in more detail below.

### **By express provision stating the relevant proportionate liability scheme does not apply**

The legislation in Western Australia, New South Wales and Tasmania expressly allows contracting out. Section 4A of the *Civil Liability Act 2002* (WA) provides:

A written agreement signed by the parties to it may contain an express provision by which a provision of Part 1A, 1B, 1C, 1D, 1E or 1F is excluded, modified or restricted and this Act does not limit or otherwise effect the operation of that express provision.

The equivalent provision in the New South Wales legislation is s 3A(2). It states:

This Act (except Part 2) does not prevent the parties to a contract from making express provision for their rights, obligations and liabilities under the contract with respect to any matter to which this Act applies and does not limit or otherwise affect the operation of any such express provision.

The Tasmanian legislation uses the same wording as in New South Wales.<sup>59</sup>

The Queensland legislation, on the other hand, expressly prohibits contracting out, since amendments passed in 2004.

The *Trade Practices Act 1974* (Cth) and the legislation in Victoria, Queensland, South Australia, the Australian Capital Territory and the Northern Territory are silent on the issue. The question therefore arises whether the parties are free to contract out of the legislation in these jurisdictions.

In the case of Victoria, the proportionate liability scheme is part of the *Wrongs Act 1958* (Vic). A number of the parts of that Act expressly state that they can be excluded by appropriate contractual provisions. The part relating to proportionate liability does not. The application of the *expressio unius est exclusio alterius* rule therefore suggests that it is strongly arguable that the parties to a contract cannot contract out of the Victorian proportionate liability scheme.

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<sup>59</sup> *Civil Liability Act 2002* (Tas), s 3A(3).

The Horan Report makes two recommendations on this point. First, it recommends that there should not be any ability to contract out of the proportionate liability legislation.<sup>60</sup> In the alternative, however, Horan recommends that a right to contract out may be introduced in all States and Territories on the basis that it is not permitted in relation to the liability of a professional or in respect of the provision of professional services.<sup>61</sup> Davis, on the other hand, supports only the first recommendation.<sup>62</sup>

SCAG has not given any indication of its position on this point and has requested submissions from key stakeholders addressing this issue.

### **By express provisions allocating liability in a particular way**

#### ***Indemnities***

Consider again the first two scenarios outlined above. It would seem that in those jurisdictions that allow the parties to contract out of the proportionate liability scheme, the owner could avoid the consequences of proportionate liability in these scenarios by obtaining appropriate indemnities from each of the designer and the builder (in the first scenario) or the head contractor (in the second scenario). The same would also appear to apply to the situation of the developer outlined above.

This, of course, assumes that the provisions in some Acts which prohibit a concurrent wrongdoer against whom judgment has been given under the Act from being required to indemnify another concurrent wrongdoer are held to apply only to common law indemnities, and not contractual indemnities (or that one of the other alternative interpretations discussed above is found to apply). As previously discussed the position on this issue is presently uncertain in New South Wales, Victoria and Queensland but this uncertainty could be removed if the recommendations of SCAG are adopted.

#### ***Head contractor liable for acts of subcontractors***

Consider again the second scenario outlined above. As mentioned in that scenario, it is usual for the head contract to contain a clause stating that a head contractor will be liable for the acts and omissions of its subcontractors. In those jurisdictions that allow the parties to contract out of the proportionate liability scheme, such a clause would enable the owner to avoid the consequences of the proportionate liability legislation in that scenario.<sup>63</sup>

#### ***Joint and several liability***

Consider again the position of an owner with respect to joint venture contractors discussed in the third scenario outlined above. In those jurisdictions that allow the parties to contract out of the proportionate liability scheme, the owner could avoid the consequences of proportionate liability by expressly providing in the contract that the liability of each of the joint venture contractors will be joint and several.

### **By referring all disputes to arbitration?**

The legislation in all jurisdictions refers to “the court” being required to apportion liability in proceedings involving apportionable claims. Does this mean it is possible to effectively contract out of the legislation by referring all disputes arising under a construction contract to arbitration or some other form of alternative dispute resolution not involving court proceedings?

The legislation in New South Wales, Victoria, the Northern Territory and Tasmania defines “court” to include tribunals. It is arguable that a tribunal includes an arbitral tribunal and that arbitrators are therefore required to apply the legislation in the same way as a court. If this is correct then, subject to the comments below regarding the Victorian legislation, it is not possible to contract out of the legislation by referring all disputes to arbitration.

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<sup>60</sup> See Horan Report, n 13, Recommendation 23.

<sup>61</sup> See Davis Report, n 14, Recommendation 24.

<sup>62</sup> See Standing Committee of Attorneys-General, n 15, Proposal 11.

<sup>63</sup> *Aquagenics Pty Ltd v Break O’Day Council (No 2)* [2009] TASSC 89 at [44]-[45].

However, even in those jurisdictions where the legislation does not expressly extend the term “court” to include tribunals, it seems that arbitrators will be obliged to apportion liability in accordance with the relevant legislation. In the recent decision of *Aquagenics Pty Ltd v Break O’Day Council (No 2)*, the Tasmanian Supreme Court confirmed that, subject to any inconsistent express contractual terms, a contract which refers a dispute to arbitration proceedings contains an implied term that the arbitrator has authority to give the parties the same relief as is available to them in a court of law.<sup>64</sup> Accordingly, it was held that where a court would be required to reduce a claimant’s damages pursuant to the proportionate liability legislation, an arbitrator must similarly reduce the claimant’s damages.<sup>65</sup>

As such, and subject to the comments below regarding the Victorian legislation, it does not appear to be possible to contract out of the proportionate liability legislation by simply referring all disputes arising under the contract to arbitration. This position will be confirmed if the proposed uniform legislation is drafted as presently proposed in the SCAG drafting instructions.<sup>66</sup>

The situation in Victoria, however, is different. Unlike the legislation in other jurisdictions, the Victorian proportionate liability scheme is the only scheme which *prohibits* a court from having regard to the comparative responsibility of persons who are not parties to the proceedings (unless the person is dead or, if a company, wound up). While the legislation gives the court power to join other concurrent wrongdoers as co-defendants, this power is contrary to the powers that an arbitrator can exercise, as an arbitrator’s power does not often extend to joining strangers to the arbitral agreement. Indeed, it is possible in the arbitration agreement to expressly negative any such power.

Stephenson suggests that the incompatibility between the Victorian proportionate liability legislation and the arbitrator’s inability to join additional parties to the arbitration proceedings will result in arbitrations being able to proceed without being governed by the legislation in Victoria.<sup>67</sup> Stephenson also suggests<sup>68</sup> that this inability will be a matter that the court will need to weigh in the balance when deciding whether or not to grant a stay of litigation while arbitration proceeds.<sup>69</sup> This arises when litigation and arbitration of the same matter are both on foot.

Conversely, in the other jurisdictions where the legislation *requires* or *allows* courts (and tribunals) to consider the responsibility of non-parties when apportioning liability between defendants, there is no reason to believe that arbitration would avoid the legislation. This is despite the fact that this may effectively prevent the efficient determination of the issue due to the plaintiff having to commence a number of proceedings to actually recover the full loss, as an arbitrator who considers a non-party’s liability still cannot force that non-party to pay damages. Such duplication is not necessary in a court where a plaintiff has the chance to commence against all solvent parties in a single proceeding.

## Debt v damages

It may be possible in some jurisdictions to avoid the legislation by framing the claim upon the loss as one for a debt rather than as damages in the same way that it was possible to do so under the previous proportionate liability schemes for defective building work in Victoria and New South Wales.<sup>70</sup> But we must be careful with transferring the method as the drafting in the new proportionate liability legislation blurs the debt/damages distinction. The new proportionate liability legislation in New

<sup>64</sup> *Aquagenics Pty Ltd v Break O’Day Council (No 2)* [2009] TASSC 89 at [21], applying *Francis Travel Marketing Pty Ltd v Virgin Atlantic Airways Ltd* (1996) 39 NSWLR 160 and *Government Insurance Office of New South Wales v Atkinson-Leighton Joint Venture* (1981) 146 CLR 206.

<sup>65</sup> *Aquagenics Pty Ltd v Break O’Day Council (No 2)* [2009] TASSC 89 at [24].

<sup>66</sup> See Standing Committee of Attorneys-General, n 15, pp 20-21.

<sup>67</sup> Stephenson, n 16 at 68.

<sup>68</sup> Stephenson, n 16 at 73-74.

<sup>69</sup> For example, under s 53 of the *Commercial Arbitration Act 1984* (NSW).

<sup>70</sup> See Stephenson, n 16 at 66.

South Wales, Victoria, Queensland and the Northern Territory extends the definition of damages to “any form of monetary compensation”.<sup>71</sup> The South Australian legislation extends the definition of damages to include “compensation”.

The Western Australian legislation does not define damages, and the common law meaning does not stretch to “any monetary compensation”. The legislation in Tasmania and the Australian Capital Territory also relies on the common law definition. It would seem then that careful drafting could avoid the legislation in Western Australia, Tasmania and the Australian Capital Territory (although, as noted above, there are easier ways on contracting out in Western Australia and Tasmania)

The distinction does not apply to federal jurisdiction claims under the *Trade Practices Act 1974* (Cth) because of the way claims arise under s 52.<sup>72</sup>

### **Forum shopping**

Forum shopping is nominating in a contract a certain jurisdiction to be the governing law of that contract.

Forum shopping is an option because of the differences in the legislation in each jurisdiction. In particular, some jurisdictions allow contracting out whilst others do not. Parties who are more likely to be plaintiffs than defendants, will want to contract out and will therefore have a preference for the New South Wales, Tasmanian or Western Australian regimes which expressly allow this. Parties to a contract have a wide discretion to choose the law applicable to their contract. That choice may only be set aside if it is contrary to public policy, that is:

- (a) the choice was made in circumstances which render it unconscionable to enforce it (ie it is unfair or oppressive to the weaker party); or
- (b) the choice conflicts with a mandatory law of the forum which would otherwise be applicable.

If the project and the parties are all located in Queensland, and the only reason why the parties choose New South Wales law to govern their contract was to avoid the application of the mandatory Queensland law which prohibits contracting out, then the choice will be set aside.

If, however, one of the parties is resident in New South Wales or there is some other bona fide reason why the parties has chosen the law of New South Wales (even though the project is in Queensland), then the choice of law will be effective and the contracting out clause will be given effect in accordance with the New South Wales scheme.

### **Effect on insurance**

Parties considering contracting out of proportionate liability legislation (where it is possible to do so) also need to consider the effect which this might have on any liability insurance which might otherwise be available. This is because most liability insurance will exclude protection for contractually assumed liability that would not ordinarily arise at law. If the insured assumes joint and several liability or an obligation to indemnify in respect of a claim that would otherwise be apportionable under the proportionate liability legislation, it will be assuming a liability that would not have otherwise arisen at law, and therefore its insurance policy will not cover the liability.

Put another way, an unintended effect of contracting out of legislation may be to invalidate the professional indemnity and/or public liability insurance policy of the party who is expected to bear this risk. Accordingly, parties wishing to contract out of the legislation will need to consider whether insurers need to be aware of, and expressly accept, the proposed risk allocation.

### **IS IT INCONSISTENT WITH THE POLICY INTENT FOR GOVERNMENT TO CONTRACT OUT OF PROPORTIONATE LIABILITY SCHEMES?**

There are some who have suggested that it is inconsistent with the policy intent of the proportionate liability schemes for government agencies to seek to contract out of the legislation. However, in some jurisdictions, Parliament has clearly provided contracting parties with the option of opting out of the

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<sup>71</sup> Though New South Wales provides two small exceptions in s 3(b)-(c).

<sup>72</sup> See Stephenson, above n 16 at 88.



scheme. In those jurisdictions where this option exists, there is no suggestion in the relevant legislation or the second reading speeches that the option should not be available to or exercised by government agencies. Accordingly, the writer does not consider a decision by a government agency to contract out of the scheme to be inconsistent with the policy intent of the legislation.

### **DRAFTING SUGGESTIONS FOR CONTRACTING OUT**

Below is a suggested clause for excluding the operation of the New South Wales proportionate liability scheme:

Proportionate liability

- (a) In this clause, “Proportionate Liability Legislation” means Part 4 of the *Civil Liability Act 2002* (NSW) (and any equivalent statutory provisions in any other state or territory).
- (b) To the extent permitted by law, the operation of the Proportionate Liability Legislation is excluded in relation to all and any rights, obligations and liabilities under this Contract, whether such rights, obligations or liabilities are sought to be enforced by a claim in contract, tort or otherwise.
- (c) Without limiting paragraph (b), the rights, obligations and liabilities of the parties under this Contract with respect to proportionate liability are as specified in this Contract and not otherwise, whether such rights, obligations and liabilities are sought to be enforced by a claim in contract, tort or otherwise.
- (d) To the extent permitted by law:
  - (i) the Contractor must not seek to apply the provisions of the Proportionate Liability Legislation in relation to any claim by the Principal against the Contractor (whether in contract, tort or otherwise); and
  - (ii) if the provisions the Proportionate Liability Legislation are applied in relation to any claim by the Principal against the Contractor (whether in contract, tort or otherwise) the Contractor will indemnify the Principal against any loss or damage the Principal is not able to recover from the Contractor because of the operation of those provisions.
- (e) The Contractor must ensure that all policies of insurance covering third party liability which the Contractor is required by this Contract to effect or maintain:
  - (i) cover the Contractor for potential liability to the Principal assumed by reason of the exclusion of the Proportionate Liability Legislation; and
  - (ii) do not exclude any potential liability the Contractor may have to the Principal under or by reason of this Contract.

It is suggested that the indemnity in para (d)(ii) will not be affected by the “no indemnity” provision in s 36 of the Act (even if s 36 does apply to contractual indemnities), because s 36 only applies to indemnities between concurrent wrongdoers, and not indemnities between the plaintiff and a concurrent wrongdoer.